

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CHANRY COMMUNICATIONS, LTD.	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period October 1, 1982	:	
through February 28, 1985.	:	

DETERMINATION

In the Matter of the Petition	:
of	:
STANLEY HENRY, AS OFFICER	:
for Revision of a Determination or for Refund	:
of Sales and Use Taxes under Articles 28 and 29	:
of the Tax Law for the Period October 1, 1982	:
through February 28, 1985.	:

Petitioners, Chanry Communications, Ltd., 425 Smith Street, Farmingdale, New York 11735, and Stanley Henry, as officer, 318 Southdown Road, Lloyd Harbor, New York 11743, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period October 1, 1982 through February 28, 1985 (File Nos. 806108 and 806109).

On April 28, 1989 and May 3, 1989, respectively, petitioners by their representative, Rivkin, Radler, Dunne & Bayh (Lawrence M. Hill, Esq., of counsel), and the Division of Taxation by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel) executed a consent to have the controversy determined on submission without hearing, with all documents and briefs to be submitted by September 21, 1989. After due consideration of the record, Thomas C. Sacca, Administrative Law Judge, renders the following determination.

ISSUE

Whether petitioner Chanry Communications, Ltd. is entitled to an exemption from sales and use taxes with respect to machinery and equipment used in the production of shopping papers or pennysavers.

FINDINGS OF FACT

Petitioners, Chanry Communications, Ltd. and Stanley Henry, and the Division of Taxation entered into a stipulation of facts which has been adopted as Findings of Fact "1"

through "5", "8", "10" through "16", "18", "19", "21" and "23" through "27". The stipulation is supplemented by Findings of Fact "6", "7", "9", "17", "20" and "22".

On July 10, 1987, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Chanry Communications, Ltd. ("Chanry") spanning the period October 1, 1982 through February 28, 1985 and assessing a sales and use tax liability in the aggregate amount of \$246,719.59, plus penalties (Tax Law § 1145[a][1]) and interest. On the same date, the Division of Taxation issued an additional notice of determination and demand for payment of sales and use taxes due spanning the same period and assessing the same amounts as above, against petitioner Stanley Henry as a person required to collect and remit taxes on behalf of Chanry. These two notices were based upon the results of a field audit of the business operations of Chanry as described hereinafter.

At the time of the filing of the petition in this case, on September 30, 1988, Chanry was a corporation residing at 425 Smith Street, Farmingdale, New York 11735. At all relevant times, Chanry was doing business in the State of New York.

Chanry owns, publishes and distributes 17 separate free-circulation pennysaver newspapers or shopping papers ("shopping papers") throughout the Long Island region. The shopping papers are circulated in specifically designated geographic areas.

The shopping papers constitute tangible personal property.

Chanry is in the business of soliciting and receiving advertisements from various advertisers. The advertisers require that these advertisements be placed in the shopping papers and that the shopping papers be distributed within specific geographic areas designated by the advertisers. The advertisers also choose, inter alia, the type of advertisement that is placed in the publication, its style and location in the format of the shopping paper, and its length and publication date(s).

The advertising order between the advertiser and Chanry indicates that a purchaser of advertising is not guaranteed a particular position within the shopping paper; that the art and make-up prepared by Chanry remain the property of petitioner; that only upon purchasing the art and make-up does the advertisement become the property of the advertiser; and that Chanry's liability for an error will not exceed the cost of the space occupied by the advertisement.

The rebate agreement between the advertiser and Chanry indicates that any rebate paid by Chanry can be reinvested in additional advertising; that the rebate will be paid only if all prior advertisements have been paid in full; and that the advertiser shall pay for the advertisements at prevailing rates at the time the advertisement appears.

The advertising rates which Chanry charges are dependent upon the geographic area in which the particular publication is to be distributed.

Chanry did not charge the advertisers sales tax on their purchases of advertisements.

Chanry prints and publishes the shopping papers and then distributes them to the public, free of any charge to them, in the specific geographic area designated by the advertiser. The distribution of these shopping papers is not subject to sales or use tax.

The purchasers of advertising in Chanry's publications understand that the publications are to be distributed by Chanry, free of charge, to the ultimate readers. Chanry has an implied contract to distribute the publication to the reading public.

Despite the advertisers' ability to designate the geographic areas in which they choose to advertise, Chanry retains complete editorial control regarding news and feature content.

As between Chanry and its advertisers, it is expressly understood that Chanry, using its own machinery, equipment and supplies, will produce, print and publish the shopping papers as well as distribute them. In exchange for the advertising and delivery of the published shopping paper to the public, the advertisers pay Chanry a fee.

Advertising revenues of the shopping papers support the operations and are in lieu of other charges that would otherwise be necessary to support the operations.

Notwithstanding Chanry's description as a shopping paper, its publications include news and feature stories, reader polls, editorials, photographs and reader correspondence.

Between 1982 and 1985, Chanry purchased approximately \$1 million in machinery and equipment for use directly and predominantly in the production of the pennysavers or shopping papers.

Chanry's machinery and equipment is used less than 5% of operating time in producing items other than shopping papers.

The purchase by Chanry of paper, ink and printing supplies is not subject to sales tax.

On or about September 11, 1984, the Division of Taxation commenced an audit of petitioners' books and records for the period at issue. The audit followed generally accepted procedures and tests consistent with the nature of the business operation and in accordance with the Tax Law.

The auditor analyzed in detail the fixed asset account and discovered that no tax had been paid by petitioners on purchases of machinery and equipment in the amount of \$2,029,813.22. Use tax due on these purchases was assessed in the amount of \$150,593.54. The auditor next reviewed an account entitled "intangible assets" which consisted of items such as "newspaper morgues" (dead issue files) and libraries of customer insertions. As petitioners had not paid any tax on these purchases of \$325,100.00, the auditor assessed use tax of \$26,820.75. The auditor also assessed use tax in the amount of \$25,040.23 on lease payments for machinery and equipment in the amount of \$314,267.51. Chanry's asset account revealed sales of assets in the amount of \$152,618.00 on which no tax was paid. Therefore, the auditor assessed sales tax in the amount of \$12,490.74. Finally, in reviewing recurring expenses, the auditor determined that petitioners had not paid sales tax on purchases of the bags used to deliver the shopping papers and on the electricity used to operate the publishing plant. The amount of purchases was \$396,127.00 and use tax of \$31,774.33 was assessed by the auditor. In summary, the total amount of sales and use tax assessed is as follows:

	Amount Subject to <u>Tax</u>	<u>Tax</u>
Use <u>Tax</u>		
Fixed Assets	\$2,029,813.22	\$150,593.54
Other Assets	325,100.00	26,820.75
Leases	314,267.51	25,040.23
Expenses	<u>396,127.00</u>	<u>31,774.33</u>
	\$3,065,307.70	\$234,228.85
Sales <u>Tax</u>		
Sale of Assets	<u>152,618.00</u>	<u>12,490.74</u>
TOTAL:	\$3,217,945.70	\$246,719.59

The Division of Taxation determined that Chanry was not registered pursuant to Tax Law §§ 1132 and 1134 until 1986, and therefore could not issue exemption certificates to its suppliers of machinery and equipment.

The auditor assessed penalty due to the substantial underreporting of tax (\$24,672.00 per quarter) and the failure of Chanry to register as a sales tax vendor with the Department of Taxation and Finance.

As a result of the audit, the Division of Taxation determined that petitioners owed additional use tax on purchases of machinery, equipment, supplies and materials as well as additional sales tax on unsubstantiated exempt sales.

The Division of Taxation disallowed a manufacturing exemption claimed by petitioners under Tax Law § 1115(a)(12) on the purchase of certain machinery and equipment used in the production of shopping papers.

Although the determinations of the Division of Taxation are wholly in dispute, the amount of the tax is not in dispute.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners argue that the distribution of shopping papers to the public constitutes a sale of tangible personal property. Since the advertisers pay the consideration to Chanry and Chanry transfers possession of the shopping papers to the advertisers' designee, i.e., the public, this constitutes a sale of tangible personal property.

The Division of Taxation argues that the printing or publishing of shopping papers for free distribution to the public does not constitute the manufacture of tangible personal property for sale within the purview of Tax Law § 1115(a)(12).

CONCLUSIONS OF LAW

A. Tax Law § 1115(a)(12) exempts from the imposition of sales tax machinery or equipment used or consumed directly and predominantly in the production of tangible personal property, for sale, by manufacturing. Tax Law § 1115(c) exempts from the imposition of sales tax electricity used or consumed directly and exclusively in the production of tangible personal property, for sale, by manufacturing.

The term "sale" is defined by Tax Law § 1101(b)(5) and 20 NYCRR § 526.7(a)(1) as "any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration." As the parties have stipulated that the shopping papers constitute tangible personal property, the issue remaining is whether petitioners were involved in a "sale" of the shopping papers published, that is, whether the shopping papers were transferred for a consideration.

B. It should be noted that, as a general rule, statutory exemptions from tax are strictly construed against the party claiming the exemption. The burden is upon petitioners to clearly establish their right to the exemption provided by Tax Law § 1115(a)(12) (Matter of Grace v. State Tax Commission, 37 NY2d 193, 371 NYS2d 715). Petitioners contend that the advertisers provide the consideration for the purchase of the shopping papers through their payments for advertising and that the distribution of the shopping papers to the public constitutes the transfer of tangible personal property to the advertiser's designee. This

contention is not supported by the facts in this matter.

There is nothing in the record to support a conclusion that the advertisers obtained title to or possession of the shopping papers for consideration. Nothing in the Advertising Order or Rebate Agreement between Chanry and the advertisers indicates that the advertisers paid for anything more than advertising space. The advertising rate is based upon the size of the advertisement and the geographic area where the shopping paper is to be distributed. Petitioners' liability for any error is limited to the cost of the space occupied by the advertisement. The art and make-up prepared by petitioners remain the property of petitioners, and only upon purchasing the art and make-up does the advertisement become the property of the advertiser. Under these circumstances, it cannot be said that the payments by the advertisers constituted consideration for the purchase of tangible personal property. In fact, such payments were made solely in exchange for the advertising services performed by petitioners.

In addition, the public does not stand in the shoes of the advertisers as designees (cf. Matter of Savemart, Inc. v. State Tax Commission, 105 AD2d 1001, 482 NYS2d 150) in their receipt or use of the merchandise. The distribution of the shopping papers to the public is a part of the advertising service provided by petitioners. The public did not receive the shopping papers in the place of the advertisers. Instead, Chanry was obligated, under its implied contract, to distribute the shopping papers to the public as part of its advertising service. Furthermore, since the shopping papers were distributed free of charge to the public, the public cannot be considered as purchasers of tangible personal property.

Since the advertising space did not entitle the advertisers to title or exclusive possession of the shopping papers, and the public cannot be considered a designee of the advertisers or purchasers of tangible personal property, the transactions between the advertisers and Chanry cannot constitute a "sale". In the absence of a showing that the products produced by the machinery and equipment were sold to customers, Chanry has not established that it is entitled to an exemption under Tax Law § 1115(a)(12) (Matter of Shanty Hollow Corporation v. State Tax Commission, 111 AD2d 968, lv denied 66 NY2d 603).

C. The rationale for the manufacturing exemption provided by Tax Law § 1115(a)(12) is the desire to avoid the pyramiding of sales tax. Because an item that is held for sale is generally subject to the imposition of sales tax, certain of the costs of producing that item, such as the machinery and equipment, were exempted from sales tax. However, in the present case, such rationale is inapplicable because the receipts from the retail sale of shopping papers to the publisher of such publication and the receipts from the sale of printing services performed in publishing a shopping paper are exempt from sales tax, and shopping papers are distributed to the public without consideration (see, Tax Law § 1115[i][A] and [B]).

In addition, under petitioners' interpretation, the sale of a shopping paper to the advertisers would be subject to the imposition of sales tax as a retail sale of tangible personal property, as the advertisers would no longer be considered purchasers of advertising, but of tangible personal property. (See, Tax Law § 1105[a].) Such an interpretation would be in direct conflict with the exemption provided by Tax Law § 1105(c)(1), which excludes advertising services from the imposition of sales tax. It is well established that inconsistency in the same statute is contrary to the intent of the Legislature, and must be avoided (Delaware County Elec. Coop., Inc. v. Power Authority of the State of New York, 96 AD2d 154, 468 NYS2d 233, affd 62 NY2d 877, 478 NYS2d 865). A statute must not be read so that one word or sentence will cancel and render meaningless another word or sentence (Albano v. Kirby, 36 NY2d 526, 369 NYS2d 655). Such a construction, resulting in the nullification of one part of a statute by another, is not permissible (Matter of Chase National Bank v. Guardian Realities, 283 NY 350; McKinney's Cons Laws of NY, Book 1, Statutes § 98). Furthermore, petitioners' interpretation is inconsistent with Chanry's own failure to collect sales tax from its advertisers.

Finally, the position of the Division of Taxation is consistent with the statutory scheme relating to shopping papers as created by the Laws of 1977 (ch 884, §§ 1, 2). Excluded from the imposition of sales tax are the receipts from the retail sale of shopping papers to the publishers, receipts from the sale of printing services performed in publishing shopping papers and receipts from the sale of paper, ink and other tangible personal property purchased for use in the publication of shopping papers. Conspicuously absent from the Tax Law is an exemption for the receipts from the retail sale of shopping papers, such being unnecessary as shopping papers, to qualify for the exemption, must be distributed to the public, without consideration (see, Tax Law § 1115[i][B]). It is apparent that the Legislature intended that the public be the transferee of the shopping papers and that the advertisers not be the purchasers subject to sales tax.

D. Petitioners' reliance upon sales tax regulation 20 NYCRR 526.6(c)(4), its examples and the cases decided thereunder is misplaced. The regulation, examples, and cases all involve transactions where consideration was provided and possession of the tangible personal property was transferred to the purchaser. For example, the regulation provides that:

"Tangible personal property which is purchased and given away without charge, for promotion or advertising purposes is not purchased for resale. It is a retail sale to the purchaser thereof, and is not taxable to the recipient of the property. (Emphasis added.)

In Envirogas, Inc. v. Chu (114 AD2d 38, 497 NYS2d 503, affd 69 NY2d 632, 511 NYS2d 228) the court concluded that a taxable sale occurred where the lessor under a gas lease received "free gas" in exchange for granting the lessee unconditional and exclusive right to extract gas from lessor's property. In Matter of Balsam Amusements (State Tax Commission, September 28, 1983) merchandise was purchased and then given away as prizes in amusement games. In these and other cases cited by petitioners, the tangible personal property was transferred for consideration. Unlike those situations, the present case does not involve any consideration for the shopping papers, nor transfer of possession to the advertisers.

E. Dealing with petitioners' claim that the shopping papers constitute newspapers, it appears that Matter of G&B Publishing Co., Inc. v. Dept. of Taxation and Finance (57 AD2d 18, lv denied 42 NY2d 807) which involved a publication nearly identical to petitioners' publication, is dispositive of the issue. The Court held that the publication was not a newspaper. (See also, Matter of Geneva Pennysaver, Inc., Tax Appeals Tribunal, September 11, 1989.)

F. Chanry would not be entitled to the exemption were it determined that title or possession had passed to the advertisers. In such a situation, the test which the courts of New York have developed with respect to the exemptions at hand would apply. The machinery, equipment and fuel will not be considered as used in the production of tangible personal property "for sale" for purposes of the manufacturing exemption when the facts indicate that the product is being manufactured primarily for use in services provided by the producer (see, Matter of Midland Asphalt v. Chu, 136 AD2d 851, 523 NYS2d 697, lv denied 72 NY2d 806; Matter of Southern Tier Iron Works v. Tully, 66 AD2d 921, 410 NYS2d 711). Here, at least 95% of the machinery and equipment's use was devoted to the publication of shopping papers which were distributed free of charge to the public, as part of the advertising service provided by Chanry. Therefore, Chanry was manufacturing the shopping papers for its own use as part of its advertising service and was not primarily in the business of selling the shopping papers separately from the services which it provided (see, Matter of Midland Asphalt v. Chu, supra; Matter of Southern Tier Iron Works v. Tully, supra; Matter of Willets Point Contracting Corp., Tax Appeals Tribunal, September 14, 1989).

G. The petition of Chanry Communications, Inc. and Stanley Henry, as officer, are

denied, and the notices of determination and demands for payment of sales and use taxes due dated July 10, 1987, together with such penalty and interest as is lawfully due and owing, are sustained.

DATED: Troy, New York
April 12, 1990

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE